

STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
GIOVAN DIPIAZZA,	:	
OFFICER OF G & G PIZZA RESTAURANT	:	DETERMINATION
D/B/A ROMA PIZZA RESTAURANT	:	
for Revision of a Determination or for Refund	:	
of Sales and Use Taxes under Articles 28 and 29	:	
of the Tax Law for the Period December 1, 1981	:	
through May 31, 1985.	:	

Petitioner, Giovan DiPiazza, officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant, 314 Middle Country Road, Coram, New York 11727, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period December 1, 1981 through May 31, 1985 (File No. 803059).

A hearing was held before Thomas C. Sacca, Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on January 11, 1990 at 1:15 P.M., with all briefs to be submitted by July 13, 1990. Petitioner appeared by John P. McElroy, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Carroll R. Jenkins, Esq., of counsel).

ISSUES

I. Whether the sales tax field audit conducted by the Division of Taxation utilized an audit method reasonably calculated to reflect the taxes due.

II. Whether petitioner proved that the result of the audit method used was unreasonably inaccurate or that the amount of tax assessed was erroneous.

III. Whether petitioner has shown that his failure to comply with the Tax Law, if so determined, was due to reasonable cause and was not due to willful neglect.

FINDINGS OF FACT

On December 20, 1985, the Division of Taxation issued a Notice of Determination and Demand for Payment of Sales and Use Taxes Due to G & G Pizza Corporation d/b/a Roma Pizza Restaurant ("G & G Pizza") for the period December 1, 1981 through May 31, 1985 and assessing a sales tax liability of \$54,101.00, plus penalty (Tax Law § 1145[former (a)(1)]) and interest. On the same date, the Division of Taxation issued an additional Notice of Determination and Demand for Payment of Sales and Use Taxes Due spanning the same period and assessing the same amounts as above, to petitioner, Giovan DiPiazza, as officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant. The notice indicated that petitioner was personally liable as an officer of G & G Pizza for taxes determined to be due from the corporation. The notices were based upon the results of a field audit of the business operations of G & G Pizza as described hereinafter.

On April 25, 1985, the Division sent a letter to Joseph Schwartz, petitioner's accountant at the time, advising him that petitioner's sales tax returns for the period December 1, 1981 through November 30, 1984 were scheduled for field audit. The letter advised that the audit would be conducted at Mr. Schwartz's office and requested that all books and records pertaining to the sales tax liability for the period under audit be made available. The letter further stated that the books and records provided should include journals, ledgers, sales invoices, purchase invoices, cash register tapes, exemption certificates and all sales tax records.

On May 22, 1985, the auditor met with petitioner's accountant to review the books and records of the business operation. The accountant informed the auditor that petitioner did not use guest checks and cash register tapes, and regularly discarded his purchase invoices. In addition, petitioner did not maintain invoices for his fixed asset purchases. To prepare the sales and use tax returns for the period in issue, the accountant used the deposits as shown on the bank statements. Cash payouts made out of the business's sales proceeds were not included in the gross or taxable receipts stated on the tax returns because the accountant was not aware of them. During the course of the meeting, the auditor requested of the accountant that the business begin to keep its purchase invoices.

On May 28, 1985, the auditor made a visit to the business premises. The business was owned by petitioner, a 50% shareholder, and the corporation's vice-president, and his brother, Anthony DiPiazza, also a 50% shareholder and the president of the corporation. The business was located in a shopping center and sold pizza, heroes, pasta, seafood and beverages. Petitioner obtained a license to sell beer on November 10, 1983 and a full liquor license on October 4, 1985. The premises consisted of 8 booths with a seating capacity of approximately 30. During the audit period, the business premises were open seven days a week, from 11:00 A.M. to 11:00 P.M.

On December 23, 1984, petitioner executed a consent having the effect of extending the period of limitations for assessment of sales and use taxes for the period December 1, 1981 through February 28, 1982 to June 20, 1985. On May 22, 1985, petitioner executed a second consent which extended the period of limitations for assessment of sales and use taxes for the same period to December 20, 1985.

On July 23, 1985, the Division sent a second appointment letter to petitioner's accountant on which was added an additional request. The letter requested that petitioner make available copies of all purchase invoices for flour purchased during the audit period, December 1, 1981 through November 30, 1984. On September 14, 1985, the accountant presented only a few purchase invoices to the auditor and explained that petitioner continued to discard the invoices despite being informed that such documents should be saved.

In response to the Division's request for flour purchases during the period December 1, 1981 through May 31, 1985, petitioner's supplier provided an approximate dollar value of merchandise sold to petitioner for the period 1981 through 1983 and a portion of 1984. Although requested to provide a breakdown of flour purchased by bags and pounds, the supplier submitted amounts which included other supplies purchased. The auditor concluded that the information supplied was insufficient to enable her to determine the amount of flour purchased during the audit period.

Given the presentation of the limited records described above and the lack of source

documentation which would detail the sales activities and the amount of sales tax collected, the auditor concluded that G & G Pizza had inadequate books and records for purposes of conducting a detailed audit and therefore determined to resort to indirect audit methodologies. More specifically, the auditor selected an audit method utilizing a rent factor obtained from the Dun and Bradstreet Credit Services Report for the period July 1976 through June 1977.

The Dun and Bradstreet Credit Services Report, which was used by the auditor in estimating the sales at issue, was introduced into evidence. The study, entitled "Cost of Doing Business", was compiled by Dun & Bradstreet, Inc. based upon Internal Revenue Service data consisting of a sample, selected before audit, of Federal income tax returns. The purpose of the study is described as follows:

"The following operating ratios for 190 lines of business have been derived to provide a guide as to the average amount spent by corporations for these items. They represent a percentage of business receipts as reported by a representative sample of the total of all Federal Income Tax returns filed for 1976-77."

For each industry, the study provides the total number of returns filed, the cost of goods sold percentage, the gross margin percentage and the percentages for selected operating expenses, including rent paid on business property. The ratio used in the audit was calculated based upon an analysis of information contained in 84,964 tax returns filed with the Internal Revenue Service for 1976-1977. The business category selected by the auditor was "eating and drinking places." The information contained in the study was taken from the Source Book of Statistics of Income, U.S. Treasury Department, Internal Revenue Service, Statistics Division. The study used was copyrighted in 1982.

In computing the additional taxable sales for the period October 1, 1982 through September 30, 1984, the auditor utilized the rent paid by the business for the fiscal years ended September 30, 1983 and September 30, 1984. The amounts, as shown on the business's Federal income tax returns, were as follows:

<u>Fiscal Year Ended</u>	<u>Amount</u>
September 30, 1983	\$ 7,589.00
September 30, 1984	17,216.00

These two tax returns were used because they were the only ones provided to the auditor. The rent paid was totalled and then divided by the Dun and Bradstreet rent factor of 4.93% to arrive at audited sales for the two-year period of \$503,144.00. The auditor subtracted from audited taxable sales the sales reported of \$134,600.00 to compute additional sales of \$368,544.00. Additional sales were then divided by the sales reported to arrive at a 273.81% increase in sales. This percentage was applied to gross sales as reported on the sales and use tax returns of the business for the period December 1, 1981 through May 31, 1985 to compute additional sales of \$694,688.00 and additional tax due of \$50,365.00 for the audit period. In addition, the auditor reviewed the only five invoices maintained by the business relating to recurring expenses, computed a margin of error and determined additional tax due of \$111.00 on these expenses.

Through discussions with Anthony DiPiazza, the auditor learned that during 1984 the business had made improvements to additional space which was to be used to expand the restaurant. In addition, the auditor was informed that the improvements had been made by Anthony DiPiazza and his brother. As the business failed to present any invoices showing the purchase of the fixed assets used in the construction, the auditor estimated the cost of the expansion to be \$50,000.00 and assessed tax due of \$3,625.00. The total amount of tax due as computed by the auditor was \$54,101.00. The auditor recommended that penalty be assessed based upon the failure of the business operation to maintain proper records.

On February 25, 1980, petitioner's brother, Anthony DiPiazza, purchased 50% of the business operation. During 1981, petitioner purchased the other 50% interest from his brother's partner. At this point in time, the premises leased for the business operation consisted of 1,120 square feet. Pursuant to a lease executed by the former owners of the business, the rental expense during the initial portion of the audit period was as follows:

<u>Period</u>	<u>Monthly Rent</u>
12/1/81 - 1/31/84	\$478.00

On January 26, 1984, the corporation entered into a new lease agreement with the owners of the building where the business was located. The leased premises consisted of 2,320 square feet

and required rental payments as follows:

<u>Period</u>	<u>Monthly Rent</u>
2/1/84 - 3/31/84	\$ 827.00
4/1/84 - 5/31/85	\$1,827.00

The additional space covered by the new lease was not initially suitable for use in the restaurant business. Following the improvements made by petitioner and his brother, a Certificate of Occupancy, dated December 6, 1984, was obtained from the Town of Brookhaven Building Department. Although rent was being paid on the additional space, it was not until the Certificate of Occupancy was obtained that such space was employed in the business operation. During the period April 1, 1984 through November 30, 1984, the monthly rental expense can be divided between the original space and the additional space as follows:

$$1,120 \text{ sq. ft.} / 2,320 \text{ sq. ft.} \times \$1,827.00 = \$882.00$$

$$1,200 \text{ sq. ft.} / 2,320 \text{ sq. ft.} \times \$1,827.00 = \$945.00$$

Thus, the rental expense for the original leased space was \$882.00 per month for the period April 1, 1984 through November 30, 1984. For the same period, the monthly rental expense for the additional space was \$945.00.

During the hearing process, the Division of Taxation cancelled the \$3,625.00 tax relating to the capital improvements and the \$111.00 tax relating to expense purchases.

At the hearing, Anthony DiPiazza testified that Joseph Schwartz had been the accountant for the business prior to the time when he and his brother took over the restaurant. Since Mr. Schwartz was familiar with the business operation, the brothers continued to employ him following their purchase of the business. According to Mr. DiPiazza, the accountant would come once a month to the restaurant to collect the checks and bank statements which he used to compute the sales and use tax returns. The accountant did not request any other information nor did the business provide any additional information. During the period that Mr. Schwartz was the accountant, petitioner and his brother never had any questions for him because they assumed he knew what records were required to complete the returns. After a period of time, the accountant would send his students to pick up the business's records. Anthony DiPiazza further

testified that he was unaware of how the sales and use tax returns were prepared and discarded his records because he was not aware that they had to be saved. He further testified that, during the audit period, cash payouts were made out of the cash register for various supplies needed for the business operation. This information was not given to the accountant because, according to Mr. DiPiazza's testimony, the accountant did not request it.

With regard to the rent expense, Mr. DiPiazza testified that a factor of 10 to 13% would have been more appropriate than the 4.93% used by the auditor. Mr. DiPiazza based his percentage on his own business experience as well as conversations with other pizza restaurant owners.

SUMMARY OF THE PARTIES' POSITIONS

Petitioner contends that the Division of Taxation made the following errors:

- (a) the Division used a Dun and Bradstreet study for the years 1976-1977 for an audit period which spanned the years 1981-1985;
- (b) the Division employed the Dun and Bradstreet business classification of "eating and drinking places" whereas the business operation did not have a license to sell beer until November 1983 and a full liquor license until October 1985;
- (c) the Division used the amount of rent paid by the business during the later years of the audit period and applied it to the earlier years when the amount of rent paid was less; and
- (d) the Division employed an amount of rent that represented a larger space than that used in the business.

Petitioner contends that reasonable cause exists for the abatement of penalties as he relied on his accountant to determine his sales tax liability and instruct him as to the records to be maintained.

It is the position of the Division of Taxation that it was proper to resort to external indices, such as the rent factor, to determine the business operation's tax liability as the business failed to maintain adequate books and records. With regard to the penalty, the Division

contends that petitioner has failed to demonstrate that it was reasonable to rely on the advice of the accountant with regard to the maintenance of records and preparation of the sales and use tax returns.

CONCLUSIONS OF LAW

A. Tax Law §§ 1135 and 1142.5 provide that a taxpayer is under a duty to maintain complete, adequate and accurate records of its sales and to make the same available for audit upon request. Tax Law § 1138 further provides that where adequate records are not maintained or made available, the Division of Taxation is entitled to resort to indirect methodologies, including external indices, in conducting audits and determining the accuracy of a taxpayer's returns as filed.

B. The Division of Taxation's resort to external indices as a method of computing sales tax liability must be founded upon a determination of the insufficiency of the taxpayer's recordkeeping which makes it virtually impossible to verify sales receipts and conduct an audit (Chartair, Inc. v. State Tax Commission, 65 AD2d 44). In such circumstances, the Division of Taxation must select a method of audit reasonably calculated to reflect tax due (Matter of Grecian Square v. State Tax Commission, 119 AD2d 948), and the burden is on petitioner to establish by clear and convincing evidence that both the method used to arrive at the tax assessment and the assessment itself are erroneous (Matter of Sol Wahba, Inc. v. State Tax Commission, 127 AD2d 943).

To determine the adequacy of a taxpayer's books and records, the Division of Taxation must first actually request the books and records (Matter of Christ Cella, Inc. v. State Tax Commission, 102 AD2d 352) for the entire period of the proposed assessment (Matter of Adamides v. Chu, 134 AD2d 776, lv denied 71 NY2d 806), and must make a thorough examination of such records (Matter of King Crab Restaurant, Inc. v. Chu, 134 AD2d 51), before proceeding to external indices to determine the taxpayer's sales tax liability.

C. Petitioner does not challenge the Division's right to resort to an indirect audit method in this case. It is undisputed that the business's sales records were inadequate, given the lack of

cash register tapes, guest checks, purchase invoices and the method of computing taxable sales on the sales tax returns. Furthermore, petitioner conceded that, except for checks and bank statements, all other records were discarded. This practice continued throughout the audit period and during the time of the audit. Under these circumstances, the use of an indirect audit method was appropriate (Matter of Licata v. Chu, 64 NY2d 873; Matter of Vebol Edibles, Inc. v. State of New York Tax Appeals Tribunal, ____ AD2d ____, 557 NYS2d 678). Thus, the only remaining issues with regard to the audit are whether the particular methods employed, or the results thereof, were irrational or erroneous.

D. When a taxpayer's records are inadequate, the Division of Taxation must select an audit method reasonably calculated to reflect the sales and use taxes due (Tax Law § 1138[a][1]; Matter of Grant v. Joseph, 2 NY2d 196, cert denied, 355 US 869). It is recognized that "the Audit Division is not responsible for demonstrating the propriety of the assessment, including the basis of its audit" (Matter of Blodnick v. State Tax Commission, 124 AD2d 437) and that "considerable latitude is given to an auditor in estimating sales under these circumstances" (Matter of Grecian Square, Inc. v. State Tax Commission, supra). It is only necessary that sufficient evidence be produced to demonstrate that a rational basis existed for the auditor's calculations (Matter of Grecian Square, Inc. v. State Tax Commission, supra; Matter of Willy Savino d/b/a Willy's Service Station, Tax Appeals Tribunal, September 22, 1988). The burden is then placed upon petitioner to show that "the result of the audit used is unreasonably inaccurate or that the amount of the tax assessed is erroneous" (Matter of Meskouris Bros. v. Chu, 139 AD2d 813).

E. Tax Law § 1138(a)(1) expressly states that a rent factor may form the basis for determining tax due. In Matter of A & J Gifts Shop v. Chu (145 AD2d 877, lv denied 74 NY2d 603), the Appellate Division determined that an estimate of sales equal to 10 times the taxpayer's rent was reasonably calculated to reflect the taxes due:

"The external index used was developed based upon a special flea market program carried out by the Department. Initially, sales were calculated based upon a Dun & Bradstreet report which found rent to generally be 4% of the cost of doing business. Accordingly, sales were calculated to be 20 times the rent. This gross

sales figure was adjusted downward to 10 times the rent on the basis of the Tax Commission's experience with the flea market program and audits of similar vendors in the industry" (id.).

F. In the matter at hand, the auditor employed a rent factor that was obtained from the 1982 copyrighted publication of Dun and Bradstreet known as "Cost of Doing Business". The auditor's use of the rent factor, as detailed in Finding of Fact "9", supra, provided a rational basis for the calculation of sales tax due. It is noted that the Division used a rent factor based upon a large representative sample (84,964) of returns filed with the Internal Revenue Service. The operating ratio was derived to provide a guide as to the average amount spent by corporations for rental expenses. In addition, the category used, "eating and drinking places", best describes the type of business operation conducted by petitioner.

In Matter of the Estate of Alicia M. Fashana d/b/a Angelo's Cornucopia (Tax Appeals Tribunal, September 21, 1989), the Tribunal remanded the matter because the record did not contain sufficient evidence to determine whether a rational basis existed for the audit computations. Unlike the Fashana matter, the record in this controversy contains the source, that is the publication and date of publication, of the chart utilized in this audit. Therefore, a determination can be made that the method used in this case was reasonably calculated to reflect the taxes due (see, Matter of A & J Gifts Shop v. Chu, supra; Tax Law § 1138[a][1]).

G. Petitioner has the burden to establish by clear and convincing evidence that the audit method was erroneous and/or the result of the audit was unreasonably inaccurate (Matter of Sol Wahba, Inc. v. State Tax Commission, supra; Matter of Surface Line Operators Fraternal Organization, Inc. v. Tully, 85 AD2d 858). Concerning the audit method employed, petitioner asserted that a more current Dun and Bradstreet study existed¹ and should have been used in the

¹Petitioner has cited Matter of Sam Kaufman, Officer of Donald Furniture Showroom Corporation (State Tax Commission, January 31, 1984 [TSB-H-84(30)S]) as proof that the Division of Taxation had a study which was closer in time to the audit period. In the Kaufman matter, a rental factor from a Dun and Bradstreet study was used to compute the sales tax liability of the business for the years 1978-1981. There is, however, nothing in the decision which indicates the year of the source documentation used in the study.

audit, that the business operation was not an "eating and drinking place" as shown on the study because the business did not have a beer or full liquor license for the whole audit period, and that the 4.93% rent factor was inappropriate. However, it was incumbent upon petitioner to produce a more current study, to establish a more appropriate category and to prove, through documentation, that the rent factor used was inappropriate. Since petitioner did not establish a more appropriate alternative, the audit method used must stand. Petitioner's allegations, without more, are insufficient to warrant an adjustment to the method of audit employed (Matter of Vebol Edibles, Inc. v. State of New York Tax Appeals Tribunal, *supra*; Matter of Mera Delicatessen, Inc., Tax Appeals Tribunal, November 2, 1989).

Furthermore, the fact that a different study might have given a better picture of the corporation's business and thus its tax liability does not satisfy petitioner's burden to establish by clear and convincing evidence that the method of audit was erroneous (Matter of Club Marakesh, Inc. v. State Tax Commission, 151 AD2d 908, *lv denied* 74 NY2d 616). Where a taxpayer's own failure to maintain adequate, accurate and complete books and

records requires resort to indirect audit techniques, exactness is not required of the Division of Taxation in arriving at its determination, and the consequences of recordkeeping failures in this regard weigh heavily against the taxpayer (Matter of Meskouris Brothers, Inc. v. Chu, *supra*). Petitioner cannot now claim that the indirect audit method employed by the Division of Taxation does not accurately reflect the business activities of the operation where petitioner failed to maintain, and systematically destroyed, the books and records which the Division could have used to establish the corporation's business activities and sales tax liability.

H. Petitioner has established, through the presentation of the rental agreements for the years at issue, that the rental expense used by the Division of Taxation was excessive for the earlier years of the audit. In addition, it was established at the hearing that, for a portion of 1984, the business was paying rent for space that was not being used in the business operation because it was being renovated. Therefore, the Division of Taxation is directed to recompute

the audit findings using the following monthly rental expenses as detailed in Finding of Fact "10":

<u>Period</u>	<u>Monthly Rent</u>
12/1/81 - 1/31/84	\$ 478.00
2/1/84 - 3/31/84	827.00
4/1/84 - 11/30/84	882.00
12/1/84 - 5/31/85	1,827.00

I. Tax Law § 1145(a)(1)(i) and former § 1145(a)(1)(ii) provided that a penalty could be imposed upon any person failing to file a return or pay over any tax within the time required but that the penalty could be abated if the failure to pay was due to reasonable cause and not willful neglect. The applicable regulation, 20 NYCRR former 536.1(b)(6), states that reasonable cause may include:

"[a]ny other cause for delinquency which appears to a person of ordinary prudence and intelligence as a reasonable cause for delay in filing a return and which clearly indicates an absence of gross negligence or willful intent to disobey the taxing statutes. Past performance will be taken into account. Ignorance of the law, however, will not be considered reasonable cause."

Petitioner asserts that he relied on the advice and instruction of his accountant as to which books and records to maintain and preserve. Petitioner further contends that he relied completely on his accountant to properly prepare the business's sales tax returns and provided him with the records requested.

In determining whether reasonable cause exists when a taxpayer relied upon the advice of a tax professional, it must be shown that the taxpayer relied in good faith on such advice and that it was reasonable for the taxpayer to rely on the advice (see, Auerbach v. State Tax Commission, 142 AD2d 390). To establish that his reliance was reasonable, the taxpayer has the burden of demonstrating that he acted with ordinary business care and prudence in attempting to ascertain his tax liability (see, United States v. Boyle, 469 US 241).

Petitioner made no attempt to ascertain the business's sales tax liability. Petitioner never questioned the accountant as to which records to maintain or how the sales tax returns were completed. Petitioner only gave to the accountant the records requested, and signed the completed returns. Hence, it is concluded that petitioner's assumption that the sales tax returns

were being properly prepared and his reliance on the advice of his accountant, without more, do not constitute reasonable cause for his failure to pay the sales tax when due (see, Matter of A & V Crown, Inc., Tax Appeals Tribunal, May 24, 1990). In addition, petitioner's inadequate and careless recordkeeping, including the failure to maintain purchase invoices, guest checks and cash register tapes, militates against a conclusion that petitioner's failure was due to reasonable cause and not due to willful neglect (cf. Matter of Dougherty Towing Co., Tax Appeals Tribunal, April 12, 1990).

J. The petition of Giovan DiPiazza, officer of G & G Pizza Restaurant d/b/a Roma Pizza Restaurant, is granted to the extent indicated in Finding of Fact "11" and Conclusion of Law "H"; the Notice of Determination and Demand for Payment of Sales and Use Taxes Due is to be modified accordingly. The petition is, in all other respects, denied.

DATED: Troy, New York

ADMINISTRATIVE LAW JUDGE